

Message Text

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TO SECSTATE WASHDC 1456

INFO AMCONSUL GUAYAQUIL

C O N F I D E N T I A L SECTION 1 OF 2 QUITO 4086

E.O. 11652: GDS

TAGS: EFIN, EC

SUBJECT: 1974 CENTRAL GOVERNMENT BUDGET

REF: QUITO 3705

SUMMARY: RESOURCES AVAILABLE TO CENTRAL GOVERNMENT AGENCIES THROUGH THE NATIONAL DEVELOPMENT FUND AND THE EARMARKING OF PETROLEUM REVENUES HAVE GROWN NEARLY AS LARGE AS THE BUDGET ITSELF. IN THE PROCESS, FINANCE MINISTRY CONTROL OVER THE MAGNITUDE OF GOVERNMENT EXPENDITURE HAS BROKEN DOWN. AUTHORITY ALREADY EXISTS FOR CENTRAL GOVERNMENT SPENDING TO INCREASE UP TO 120 PERCENT THIS YEAR, AND THE ACTUAL INCREASE IS LIKELY TO BE ABOUT 60 PERCENT. AS A RESULT, INFLATIONARY PRESSURES WILL CONTINUE STRONG, EVEN IF THE GOE FINDS A WAY TO SOLVE FOOD SUPPLY PROBLEMS. END SUMMARY.

1. MORE THAN HALF OF ECUADOR'S PETROLEUM REVENUES NOW ACCRUE TO CENTRAL GOVERNMENT AGENCIES OUTSIDE THE TRADITIONALLY DEFINED BUDGETARY PROCESS, EITHER AS TAXES EARMARKED FOR DIRECT PAYMENT TO THE RECIPIENT AGENCY OR THROUGH THE NATIONAL DEVELOPMENT FUND, CONFIDENTIAL

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ESTABLISHED DECEMBER 1973. EACH RECIPIENT ENTITY GOVERNS THE

RATE OF EXPENDITURE OF PETROLEUM REVENUES EARMARKED FOR IT, AND LARGE SUMS FROM THE NATIONAL DEVELOPMENT FUND ARE BEING COMMITTED WITH ONLY SUPERFICIAL CONSIDERATION OF MONETARY EFFECTS. CONSEQUENTLY, EFFECTIVE CONTROL OF THE MAGNITUDE OF CENTRAL GOVERNMENT SPENDING HAS SLIPPED FROM THE GRASP OF THE MINISTRY OF FINANCE.

2. WITH SUBSTANTIAL RESOURCES NOW AVAILABLE FROM EARMARKED PETROLEUM REVENUES AND THE NATIONAL DEVELOPMENT FUND IN ADDITION TO THE BUDGET ITSELF, CENTRAL GOVERNMENT SPENDING IS RAPIDLY ACCELERATING. ALTHOUGH SENIOR GOE OFFICIALS ARE GENERALLY AWARE THAT, IN A FREQUENTLY USED PHRASE, THE MONETIZATION OF PETROLEUM REVENUES CAN CAUSE INFLATION, THEY HAVE PROVED UNWILLING IN PRACTICE TO MODERATE THEIR DEMANDS UPON GOVERNMENT RESOURCES. MINDFUL OF THE COUNTRY'S NEEDS -- AND PERHAPS OF THEIR OWN AMBITIONS -- MANY CABINET OFFICERS HAVE DEVOTED THEMSELVES TO OBTAINING MAXIMUM SHARES OF PETROLEUM REVENUES FOR INVESTMENT IN THEIR PARTICULAR AREAS. INsofar AS THEY PERCEIVE MONETARY EFFECTS, MOST SENIOR OFFICIALS PREFER SOME INFLATION TO DELAY IN ATTACKING ECUADOR'S DEVELOPMENT PROBLEMS, AND NONE APPEARS TO REALIZE THAT GOVERNMENT ENTITIES ARE NOW COMPETING AMONG THEMSELVES FOR A LIMITED SUPPLY OF REAL DOMESTIC RESOURCES, HUMAN AND MATERIAL. MINFIN MONCAYO HIMSELF IS WILLING TO TOLERATE SOME INFLATION, ONE REASON WHY HE PUTS LESS EMPHASIS ON FISCAL RESTRAINT THAN HIS PREDECESSOR, ENRIQUE SALAS. IF ALL BUDGETED AND EXTRA-BUDGETARY (EARMARKED REVENUES AND NATIONAL DEVELOPMENT FUND) PROGRAMS AUTHORIZED FOR THIS YEAR WERE TO BE FULLY EXECUTED (THEY WILL NOT BE), CENTRAL GOVERNMENT SPENDING WOULD RISE BY A POTENTIALLY DESTABILIZING 120 PERCENT THIS YEAR.

3. BUDGET: SPENDING AUTHORITY UNDER THE 1974 CENTRAL GOVERNMENT BUDGET IS WELL-DEFINED BUT NOT MONETARILY VERY RESTRICTIVE. IN ITS INITIAL PUBLISHED FORM, THE 1974 BUDGET AUTHORIZED EXPENDITURE OF 10,386 MILLION SUCRES (\$415 MILLION); AS IN PREVIOUS REPORTING, DEBT AMORTIZATION IS EXCLUDED FROM THIS FIGURE. THE INITIAL BUDGET REPRESENTS AN EXPANSION OF 14 PERCENT WITH RESPECT TO THE FINAL CODIFIED 1973 BUDGET (INITIAL BUDGET PLUS ALL SUPPLEMENTARY APPROPRIATIONS) BUT 30 PERCENT WITH RESPECT TO ACTUAL 1973 EXPENDITURE. SINCE THEN THE GOE HAS APPROPRIATED AN ADDITIONAL 1,400 MILLION SUCRES (\$56 MILLION). AT 11,800 MILLION SUCRES, THE BUDGET NOW AUTHORIZES CENTRAL GOVERNMENT SPENDING

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TO EXPAND 47 PERCENT.

4. EARMARKED REVENUES: PETROLEUM REVENUES EARMARKED FOR SPECIFIED ENTITIES WILL COME TO ABOUT 6,000 MILLION SUCRES (\$240 MILLION) IN 1974, AT PRESENT PRICES AND PRODUCTION OF 210,000 BPD FOR REMAINDER OF YEAR, AND ASSUMING THAT EARMARKING IS UNDISTURBED BY THE GOE'S PURCHASE OF 25 PERCENT OF TEXACO-GULF SHARES. OF THIS AMOUNT, THE MILITARY SERVICES AND THE NATIONAL

DEFENSE COUNCIL WILL RECEIVE 2,300 MILLION SUCRES, THE ELECTRICIFICATION INSTITUTE (INECEL) 2,170 MILLION SUCRES, THE MINISTRIES OF LABOR AND HEALTH AND THE HOUSING BANK A TOTAL OF 920 MILLION SUCRES FROM THE WORKERS' SHARE OF PROFITS, AND OTHER ENTITIES THE REMAINDER. THE RECIPIENT ENTITIES DECIDE FOR THEMSELVES THE RATE OF USE OF THIS MONEY.

5. ACTUAL 1974 EXPENDITURE OF EARMARKED PETROLEUM REVENUES WILL CERTAINLY FALL SHORT OF THE FULL AMOUNT DUE TO DELAYS IN THE EXECUTION OF SOME PROJECTS. THE INECEL BUDGET FOR 1974 OF 2,297 MILLION SUCRES QUADRUPLES ACTUAL 1973 SPENDING OF 509 MILLION SUCRES. THUS SOME UNDERSPENDING IS TO BE EXPECTED BY INECEL AND FOR THE SAME REASON, BY OTHER NON-MILITARY RECIPIENTS OF EARMARKED REVENUES. IN THE CASE OF THE ARMED FORCES, THE LION'S SHARE OF EXPENDITURE FROM ROYALTY INCOME WILL BE FOR PURCHASES OF IMPORTED EQUIPMENT AND WILL NOT CONTRIBUTE TO INTERNAL INFLATIONARY PRESSURES. THE DOMESTIC COMPONENT OF MILITARY SPENDING FROM EARMARKED REVENUES IS OF INTEREST, HOWEVER, AND MAY BE IN THE NEIGHBORHOOD OF 500 MILLION SUCRES.
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C O N F I D E N T I A L SECTION 2 OF 2 QUITO 4086

6. NATIONAL DEVELOPMENT FUND: COMMITMENTS FROM THE FUND HAVE

ALREADY REACHED 3,055 MILLION SUCRES (\$122 MILLION), AND ANOTHER 15-20 PROJECTS ARE APPROVED IN PRINCIPAL OR UNDER CONSIDERATION (REFTEL). ONCE COMMITTED, THE RATE OF EXPENDITURE OF THESE FUNDS PASSES FROM CENTRALIZED CONTROL. COMMITMENTS UNDERTAKEN IN 1974 FOR DISBURSEMENTS THIS YEAR AND BEYOND APPEAR CERTAIN TO EXCEED THE FUND'S 1974 RECEIPTS, ESTIMATED BY MINFIN MONCAYO AT 3,600 MILLION SUCRES (\$144 MILLION). EMBASSY ESTIMATES THAT 1974 DISBURSEMENTS WILL FALL IN THE RANGE OF 1250 TO 1875 MILLION SUCRES (\$50-75 MILLION) PLUS ANY AMOUNT PAID TO TEXACO-GULF FOR PURCHASE OF 25 PERCENT OF ITS SHARES.

7. TOTALLING THE BUDGET AND EXTRA-BUDGETARY AVAILABILITIES, THE CENTRAL GOVERNMENT COULD THEORETICALLY SPEND 21,000 MILLION SUCRES (\$840 MILLION) THIS YEAR. ACTUAL EXPENDITURE WILL BE MUCH LESS, BUT STILL FAR IN EXCESS OF LEVELS CONDUCIVE TO ECONOMIC STABILITY. ONE WAY TO ESTIMATE ACTUAL EXPENDITURE IS TO ASSUME THE RATIO OF ACTUAL TO BUDGETED EXPENDITURE WILL REMAIN THE SAME AS IN RECENT YEARS. ACTUAL EXPENDITURE WAS 81 PERCENT OF THE FINAL CODIFIED CENTRAL GOVERNMENT BUDGET IN 1972 AND 88 PERCENT IN 1973. IF 85 PERCENT IS USED AS AN APPROXIMATION, CONFIDENTIAL

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THE CENTRAL GOVERNMENT BUDGET WOULD BE EXECUTED TO THE EXTENT OF 10,000 MILLION SUCRES, INECEL WOULD SPEND 2,000 MILLION, AND ENTITIES RECEIVING EARMARKED REVENUES (APART FROM INECEL AND THE MILITARY) 1,300 MILLION. ADDING TO THIS 500 MILLION BY THE MILITARY AND 1,500 MILLION FROM THE NATIONAL DEVELOPMENT FUND, 1974 CENTRAL GOVERNMENT EXPENDITURE WOULD BE 15,300 MILLION SUCRES (\$612 MILLION).

8. THE COMPARABLE SUM FOR 1973 WOULD INCLUDE SPENDING UNDER THE BUDGET (KNOWN) AND FROM EARMARKED REVENUES (UNKNOWN). USING ACTUAL INECEL EXPENDITURE AND AN ESTIMATED 85 PERCENT EXPENDITURE OF OTHER EARMARKED REVENUES, 1973 CENTRAL GOVERNMENT EXPENDITURE WOULD HAVE BEEN 9,500 MILLION SUCRES. ON THIS BASIS, CENTRAL GOVERNMENT EXPENDITURES WILL GROW APPROXIMATELY 61 PERCENT IN 1974.

9. COMMENT: THERE IS NOT REALISTIC WAY, NEITHER THROUGH GREATER IMPORTS NOR IMPROVED DOMESTIC PRODUCTION, TO INCREASE REAL RESOURCES AVAILABLE TO THE CENTRAL GOVERNMENT THIS YEAR BY NEARLY TWO-THIRDS. IMPORTS CAN SUPPLY PART OF THE INCREASED DEMAND, AND THROUGH APRIL IMPORT PERMITS GRANTED ARE UP 75 PERCENT OVER THE PREVIOUS YEAR. HOWEVER, THE DOMESTIC SUPPLY OF HUMAN AND MATERIAL RESOURCES CANNOT BE BEEFED UP SO QUICKLY. THEREFORE, THE OUTLOOK IS FOR CONTINUED INFLATION AT UNPRECEDENTED RATES (60 PERCENT ANNUAL RATE THROUGH APRIL) AND, EVENTUALLY, PAINFUL DISTORTIONS IF POLICIES TO DEAL WITH INFLATION ARE NOT PERFECTED.

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